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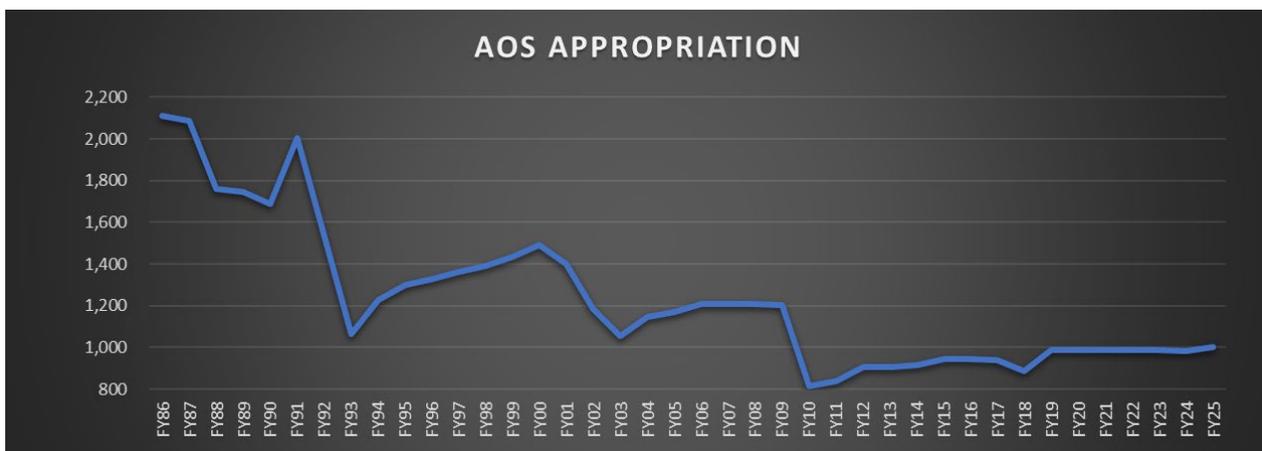
Rob Sand  
Auditor of State

### **Auditor of State FY27 Appropriation Increase Request**

This background memo outlines the reasoning and support behind the Auditor's request for an increase in appropriation. For the last several years, AOS has advocated for this **revenue-neutral legislation** that would fix funding issues identified by federal officials.<sup>1</sup> Seeking an increased appropriation is a less comprehensive but still helpful approach to the same issue, while curtailing future AOS billing rate increases. Holding down the rates will also benefit local governments.

**Increasing the appropriation will be overall revenue neutral** to the state. Increasing the appropriation will help hold down billing rates for all state agencies. AOS audits all state agencies but is only paid for some, meaning the billed agencies carry the burden of all of rising costs.

The Auditor seeks an increase in appropriation to cover rising costs. The increase sought this year is intended to reduce billing rates for both state agencies and local governments. It should be noted that the Auditor is appropriated at a level **less than it was in 1990, without adjusting for inflation.**<sup>2</sup>



Iowa law lays out which state agencies AOS bills at an hourly rate for their audit, and which are covered by the AOS appropriation.<sup>3</sup> For FY27, AOS has requested an appropriation of \$1.7M. This is essentially the same amount AOS received in 1990, the year the current funding model was adopted.<sup>4</sup>

<sup>1</sup> TLSB 1304DP, <https://www.legis.iowa.gov/docs/publications/BP/1208217.pdf>

<sup>2</sup> In order to keep up with inflation, AOS would need an appropriation of \$5M.

<sup>3</sup> Iowa Code 11.5B

<sup>4</sup> 1990 Iowa Legis. Serv. S.F. 2427 (Ch. 1247) (West)

Each year, the annual appropriation bill tasks AOS with auditing the annual comprehensive financial report (ACFR) of the state.<sup>5</sup> The amount appropriated is approximately 10% of the annual AOS budget. The vast majority of the remaining budget is generated by billing for the work performed, time for which is charged by individual auditors at hourly rate.<sup>6</sup> In order to complete the ACFR, as well as to comply with statutory duties, AOS is required audit each and every agency, though it can only bill for some.<sup>7</sup>

It is important to recognize that AOS does not, and has never, reviewed every transaction of the state as part of procedures, nor does it perform the same procedures at all agencies.<sup>8</sup> Doing so would be inadvisable because it would be inefficient and predictable. Instead, AOS follows Government Auditing Standards to determine risk and then ascertain necessary procedures.<sup>9</sup>

For purposes of ACFR, the State is divided into “material” and “non-material” agencies. Generally speaking, AOS uses a percentage of total expenditures to determine materiality.<sup>10</sup> For departments material to the ACFR, AOS performs a robust review of internal control and transaction testing – because that’s where there is the most significant activity and balances.<sup>11</sup>

Most material agencies are billable by AOS-- HHS, Transportation, and Education are “material,” accounting for significant percentages of state finances, and Iowa law states AOS must bill them all for their audit work.<sup>12</sup> However, agencies such as Revenue, Economic Development, and Public Safety are material but not billable.

**MATERIAL STATE AGENCIES  
AOS CANNOT BILL**

- Revenue
- Judicial Branch
- Treasurer
- Homeland Security
- Public Safety
- Iowa Economic Development Authority

<sup>5</sup> 2023 GA SF 557, (p. 4)

<sup>6</sup> Current AOS billing rates average less than \$100/hr.

<sup>7</sup> Iowa Code 11.2

<sup>8</sup> The State’s Net Position is \$29.5 billion, which does not include the component units such as IFA, IEDA, State Fair and Lottery

<sup>9</sup> Under AU-C 315, auditor judgment determines the scope of work for each individual agency/fund based on the risk assessment procedures performed to determine the nature, timing and extent of testing needed.

<https://us.aicpa.org/content/dam/aicpa/research/standards/auditattest/downloadabledocuments/au-c-00315.pdf>

<sup>10</sup> E.g., Department of Transportation (11% of total FY20 state expenditures) is material, while Cultural Affairs (.06%) is not.

<sup>11</sup> For material agencies, this work includes testing and supporting cash and investments, receivables, prepaids, loans receivable, leases receivable, inventories, capital assets, accounts payable, leases payable, compensated absences payable, bonds and notes payable. AOS selects individually significant items (as calculated) and a sample of other transactions. The GAAP package prepared by agencies are tested and supported, and transactions are sampled and tested.

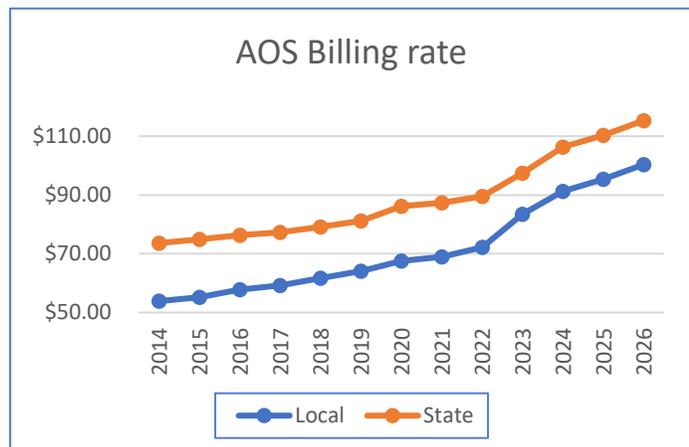
<sup>12</sup> Iowa Code 11.5B

In keeping with standards, far fewer procedures are performed at “non-material” agencies.<sup>13</sup> Standards dictate the auditor’s determination of materiality is a matter of professional judgement and is affected by the auditor’s perception of the financial information needs of users of the financial statements.<sup>14</sup> Generally speaking, AOS uses a percentage of total expenditures to determine materiality.<sup>15</sup> <sup>16</sup> In sum, all agencies are audited annually, but material agencies are examined in greater detail than non-material.

Importantly, most of the billable agencies receive federal dollars, which means they can charge their audit costs to their federal dollars.<sup>17</sup> Federal officials audit these expenses by reviewing the Statewide Cost Allocation Plan. (“SWCAP”). Beginning with FY17, SWCAP auditors determined that the discrepancy between billable and non-billable agencies had resulted in the federal government being overcharged for audit costs. They determined that unless this issue was remedied, SWCAP would demand repayment of the overage.<sup>18</sup> AOS raised this issue in each of the last five legislative sessions, but the proposed bill has not received so much as a subcommittee hearing.

In the meantime, the gap identified by SWCAP has continued to grow. Over the last years, billing rates have substantially increased across the accounting and auditing industries due to a nationwide workforce crisis, which has further increased the cost of the ACFR and the gap between billed and unbilled ACFR expenses.

AOS has made considerable effort to reduce its uncompensated expenses. In 2014, AOS spent \$1.7M on non-billable work, roughly twice what the appropriation paid for—the rest was made up through billing for billable work. Beginning in 2020, when SWCAP informed AOS of its position on the FY2017 gap, AOS began efforts to reduce the gap. Last year, AOS did just over \$1M in non-billable work, much closer to the \$989000 appropriation.



AOS budgets 45,000 hours of staff time for the ACFR each year.<sup>19</sup> Approximately 16,000 hours are designated as work to be performed at non-billable agencies. The cost of performing procedures at material non-billable agencies should

<sup>13</sup>At non-material agencies, AOS analytical procedures on the GAAP reporting packages for purposes of ACFR and reviews internal controls. AOS also follows-up on prior findings to determine if they have been corrected, but generally does not perform transaction level testing at non-material agencies.

<sup>14</sup> AU-C 320, <https://us.aicpa.org/content/dam/aicpa/research/standards/auditattest/downloadabledocuments/au-c-00320.pdf>

<sup>15</sup> E.g., Department of Transportation (11% of total FY20 state expenditures) is material, while Cultural Affairs (.06%) is not.

<sup>16</sup> Other factors leading to materiality designation include major federal programs, significant funds, and past findings. Planning materiality and sampling guidance are based on Chapters 3 and 7 of the Practitioners Publishing Company’s Guide to Audits of Local Governments (GALG).

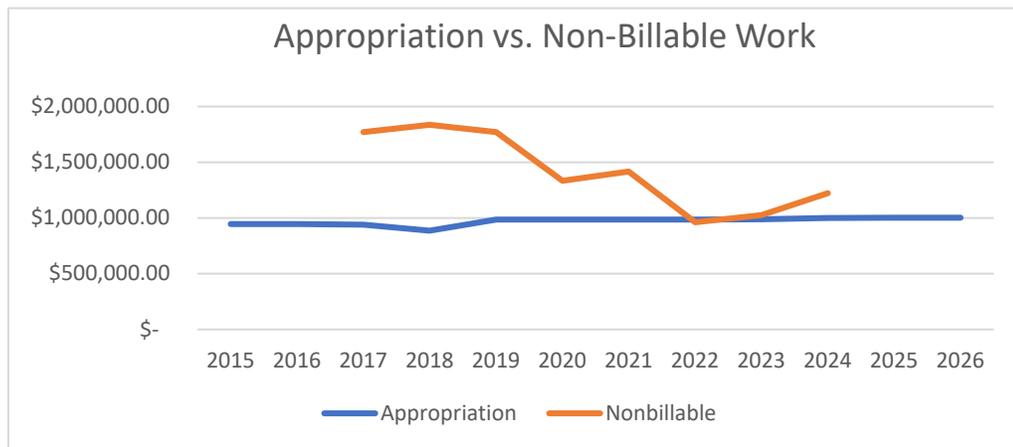
<sup>17</sup> 200 CFR 425 <https://www.ecfr.gov/current/title-2/subtitle-A/chapter-II/part-200/subpart-E/subject-group-ECFR425.425>

<sup>18</sup> [https://www.legis.iowa.gov/docs/publications/bgs/87179\\_5226DP.\(funding\\_reform\)\\_backgroundstatement.pdf](https://www.legis.iowa.gov/docs/publications/bgs/87179_5226DP.(funding_reform)_backgroundstatement.pdf)

<sup>19</sup> This number does not include hours worked at agencies that also receive a separate audit report, such as the Regents institutions or the State Fair.

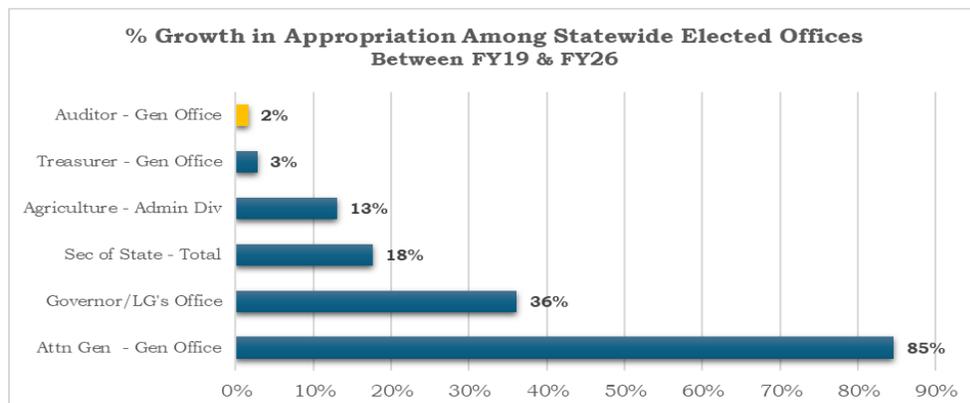
be compensated under the AOS appropriation. However, due to the budget constraints, and a lack of available staff, AOS has been forced to reduce its ACFR oversight work by approximately 6,000 hours. These hours have been redirected to local government jobs for which AOS is paid. This shift is a result of Iowa law’s distinction between billable and nonbillable agencies, which AOS has been asking to have fixed for the last five years.

This reduction does not impact the AOS ACFR opinion, because it’s a reduction at non-material agencies. However, it is a significant reduction in the amount of oversight and assistance given to agencies that are non-material and non-billable. This is work that was done previously and should still be done. However, under the current billing/appropriation scheme, it can’t be done without further running afoul of SWCAP and/or imposing impossibly high billing rates on local governments.



Simply put, the appropriation does not go as far as it did 10 years ago. Over the last several years, personnel costs and audit requirements have risen, meaning that there is more work to do, and it costs more to do it.<sup>20</sup> In sum, the easiest explanation for the appropriation request is this: We have 16,000 hours of non-billable work that we must do to complete the ACFR; we’re only getting paid for 10,000 hours. The appropriation should cover the work performed on non-billable agencies.

During the last seven years, every statewide elected official has received an increased appropriation—except the auditor. This appropriation increase – or the proposed statute allowing AOS to bill all agencies is a necessary step to adjust for the rising costs.



<sup>20</sup> GASB standards have added additional requirements (GASB 87, GASB 68), which have added time to audit procedures.